Access to Microfinance & Improved Implementation of Policy Reform (AMIR Program)

Funded By U.S. Agency for International Development

Board Governance Technical Training Workshop

Final Report

Deliverable for SMI Component, Task No. 3.2.12
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August 2001

This report was prepared by Graham Perrett in collaboration with Chemonics International Inc., prime contractor to the U.S. Agency for International Development for the AMIR Program in Jordan.

Board Governance Technical Training Workshop

26 July 2001

Summary

Memorandum To: Mr. J. Whitaker, Component Leader

From: G. D. Perrett, Consultant

Re: Workshop on Board Governance.

Date: July 29, 2001.

The above workshop was held at the Qasr Hotel during the morning of Thursday, July 26, 2001. The logistics of the workshop were organized by the Training Team from AMIR, to whom gratitude is expressed. The attendees were as follows:

Mr. J. Kattan	Chairman, AMC
Mr. G. Abu-Yaghi	General Manager, AMC
Ms. N. Abboushi	Vice Chair, MFW
Ms. S. Tieby	Director, MFW
Mr. B. Khanfar	General Manager, MFW
Ms. R. Salti	Director, MFW
Ms. N. Talhouni	Resident Vice President, Citibank
Mr. J. Whitaker,	AMIR SMI Component Leader.
Ms. S. Qadoura,	AMIR Public Awareness and Training Manager.
Ms. R. Tell	Events and Training Assistant

The idea of the workshop was to provide the Directors of MFIs with a basic understanding of the general principles and practices of microfinance, so that they would have a clearer understanding of their roles and responsibilities. The basic agenda for the workshop was as follows:

-The definition of microfinance
-The status of the supply of and demand for microfinance in Jordan
-Methodologies
-Products
-The general principles of microfinance
-Critical Success Factors for an MFI
-Warning signs of future problems
-The required skills for an MFI management team and what they should, and should not, be doing.
-Key ratios and technical terms
-Crisis management

Unfortunately, none of the directors from JMCC attended, despite being the instigators of the workshop, and only one director from AMC was present. These absences are regrettable, since the one of the two outside Directors who did attend requested a follow-up meeting to discuss further some of the issues that were raised. Moreover, with the

MFIs now poised to commence borrowing from the Wholesale Funding Facility, the need for the Board to be knowledgeable about microfinance is even more acute.

Despite the low attendance, the interaction amongst the group was good, with the more experienced practitioners contributing practical comments and insights into undertaking microfinance in Jordan. Several issues arose during the course of the workshop, which are discussed below, together with some observations:

(i). There was considerable interest about the various microfinance methodologies that can be used by MFIs, and how MFIs can offer a range of these methodologies to differing sectors of their target market. This level of interest displayed suggests that new Directors joining the Board of the MFIs should be briefed about microfinance in general, their roles and responsibilities as Directors, and details about their organization in particular, before they accept or reject the invitation to join the Board. This would permit them to make a more informed decision about what role they can play in helping strengthen the individual MFI . This information could be provided by the preparation of a booklet, or Director's Handbook about microfinance that would be distributed to them, and would be updated periodically.

(ii). The group spent a considerable amount of time discussing both the number of the microfinance providers in Jordan, and the performance of the quasi-public sector providers compared to the MFIs working under the AMIR Program. This interest provided the opening for raising and emphasizing the need for the adoption of a clear, focused marketing strategy by their respective MFIs, in which the Directors need to be closely involved.

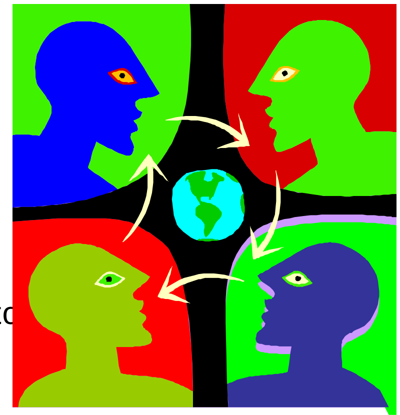
(iii). There was great interest in the approach taken by FATEN for managing its way through the Intifada Crisis. In particular, as to how FATEN classified its portfolio into those clients who could not pay, those who would not pay and those who did pay, and how each of these categories were managed. When circumstances permit, it might be useful to invite Mohammed Khalid to give a presentation to both board members and the respective executive directors on how FATEN was able to survive and prosper.

(iv). Directors were interested in learning how the operational sustainability of the AMIR sponsored MFIs compared with other international practitioners. This was particularly noteworthy regarding the fairly rapid ramp-up in the ratio over the preceding 2-3 years of the AMIR supported MFIs.

(v). While the planned agenda was covered, the workshop ran behind schedule primarily due to the higher than anticipated level of involvement by the attendees. In particular the status of the microfinance market in Jordan, and questions regarding the comparison of the local MFIs with other international practitioners were discussed at length. Consequently, the workshop had to move fairly swiftly through the section on ratios, with the majority of the discussion focusing on eight critical formulae. In retrospect, this limited focus on ratio analysis may prove to be a positive, since these ratios will stand-out in the attendees' minds, rather than being subsumed in a lengthy list of 18 ratios in total. To encourage directors to focus on these key ratios, a section on ratio analysis could be included in the Director's Handbook, which has been suggested in (i) above.

Questionnaire

MFI Board of Directors Information Workshops



Please take a moment to complete and return this form to Hanadi Derhalli at the AMIR Program (fax 560-3599).

Thank you again for your continued cooperation.

(please list your MFI name)

Technical Aspects of Being an MFI Board Member Workshop
Half-Day Morning Session
July 26, 2001

Please list the Individuals who expect to attend:

1.
2.
3.
4.
5.
6.

Board Governance Workshop
One and one-half day Session
August 7-9, 2001

Please indicate your preference for your MFI's half-day session (we will do our best to accommodate your first choice):

W August 7, morning
W August 7, afternoon
W August 8, morning
W August 8, afternoon

Please list the Individuals who expect to attend:

1.
2.

3.

4.

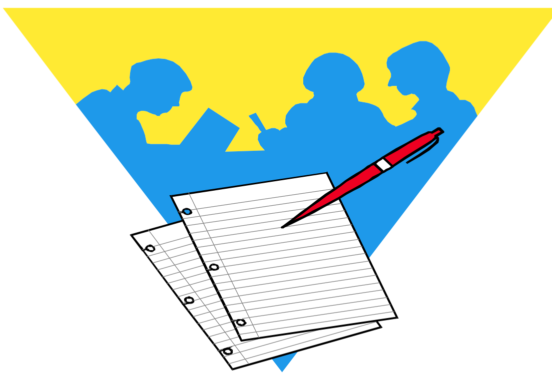
5.

6.

Your response before June 27th, 2001 will be appreciated

Hand Outs

TECHNICAL ASPECTS OF BEING AN MFI BOARD MEMBER



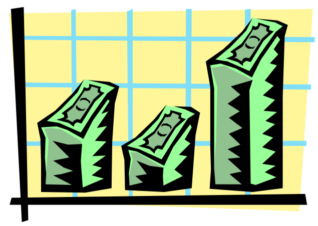
July 26, 2001

INTRODUCTION:

WHAT IS MICROFINANCE?

FORMAL DEFINITION OF MICROFINANCE

THE PROVISION OF FINANCIAL SERVICES TO THE POOR WHO ARE NOT ADEQUATELY SERVICED BY THE FORMAL FINANCIAL SECTOR.



MICROFINANCE IS BANKING/LENDING.

1). IF A LOAN IS EXTENDED, YOU WANT THE PRINCIPAL AND INTEREST REPAID ON TIME.

2). YOU WANT TO COVER YOUR COSTS.

3). IF YOU COLLECT DEPOSITS, YOU WANT TO RE-LEND THEM AT A POSITIVE RATE.

4). MICROFINANCE IS ALL ABOUT ECONOMIES OF SCALE.

HOW IS MICROFINANCE DIFFERENT FROM BANKING?

1). THE LOAN SIZE IS SMALLER.

2). SOCIAL CAPITAL RATHER THAN PHYSICAL COLLATERAL/ SECURITY IS USED

3). A DIFFERENT APPROACH IS TAKEN TO ACHIEVING ECONOMIES OF SCALE

4). THE LEGAL STATUS OF MICROFINANCE INSTITUTIONS NORMALLY IS DIFFERENT FROM COMMERCIAL BANKS.

5). STREAMLINED, RAPID LOAN APPROVAL PROCEDURES

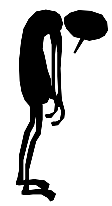
6). STRONG PROBABILITY OF A REPEAT LOAN IF THE CURRENT LOAN IS REPAID ACCORDING TO SCHEDULE.

7). CAN BE MORE LABOR INTENSIVE THAN ORDINARY COMMERCIAL BANKING.

8). THE ROLE OF THE LENDER OF FIRST AND LAST RESORT.

WHO ARE THE POOR?

VARIOUS DEFINITIONS ARE USED, BUT THE MOST WIDELY ACCEPTED IS: A POTENTIAL CLIENT WHO NEEDS TO BORROW A SUM OF LESS THAN TWICE THE AMOUNT OF THE HOST COUNTRY'S PER CAPITA INCOME. THIS AMOUNTS TO APPROXIMATELY 2,350 JD.



A FURTHER REFINEMENT IS THAT THE DEFINITION NOW INCLUDES THOSE WHO DO NOT HAVE ACCESS TO THE FORMAL FINANCIAL SECTOR.

BRIEF HISTORY

-INTERNATIONAL

THE FUNDING OF SMALL BUSINESSES IS NOT NEW, AND PROBABLY STARTED IN THE "GOLDEN CRESCENT" REGION BETWEEN THE TIGRIS AND EUPHRATES.

GENERALLY ACCEPTED THAT MODERN DAY MICROFINANCE WAS STARTED BY DR. MOHAMMED YOUNIS IN 1973, WHICH WAS THEN FOLLOWED BY THE FOUNDING OF GRAMEEN BANK IN 1974.

- JORDAN

THE FIRST FORMAL INSTITUTION THAT INCLUDED IN ITS MANDATE THE RESPONSIBILITY OF EXTENDING LOANS TO MICROBUSINESSES WAS THE AGRICULTURAL CREDIT CORPORATION, WHICH WAS FOUNDED IN 1959

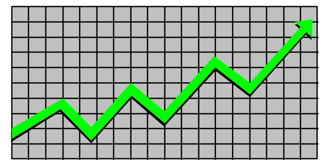
THE FIRST FORMAL MICROLENDING PROGRAM WAS ESTABLISHED BY THE INDUSTRIAL DEVELOPMENT BANK IN 1965. ADDITIONAL PROGRAMS WERE CREATED FROM WITHIN THE PUBLIC SECTOR BY GUVS IN 1986 AND DEF IN 1992.

THE CONCEPT OF SUSTAINABLE MICROFINANCE WAS INTRODUCED INTO JORDAN BY SAVE THE CHILDREN, WHEN THEY STARTED THE GROUP GUARANTEED LENDING AND SAVINGS PROGRAM IN THE MAHATTA AND NATHEEF REFUGEE CAMPS. THIS PROGRAM WAS FORMALIZED BY THE CREATION OF JORDANIAN WOMEN'S DEVELOPMENT SOCIETY IN 1997.

THE AMIR PROGRAM COMMENCED OPERATIONS IN FEBRUARY, 1998.

GENERAL PRINCIPLES OF SUCCESSFUL MICROFINANCE PROGRAMS

1). THE POOR ARE BANKABLE. THEY CAN AND DO SAVE; AND THEY ARE CAPABLE OF REPAYING LOANS THAT ARE WELL DESIGNED, CORRECTLY APPRAISED AND APPROPRIATELY MANAGED.



2). CLIENTS ARE PREPARED TO PAY MARKET RATES OF INTEREST

3). THERE IS A FIRM COMMITMENT FOR MFIs TO BECOME SUSTAINABLE (PROFITABLE) WITHIN 5-7 YEARS.

4). MICROFINANCE IS NOT CHARITY, IT IS RUN AS A BUSINESS- USING SOUND BUSINESS PRINCIPLES.

5). THE IMPORTANCE OF A GOOD CREDIT CULTURE IN THE MARKET.

6). THERE IS A GENERAL FOCUS OF LENDING FOR BUSINESS PURPOSES- ALTHOUGH THIS IS NOW WEAKENING.

7). THE IDEA OF TARGETING CERTAIN SEGMENTS OF THE POPULATION, WHILE HAVING CERTAIN SOCIAL MERITS, CAN BE DELETERIOUS TO AN EFFECTIVE MICROFINANCE PROGRAM.

TYPICAL METHODOLOGIES

VILLAGE BANKING:

CLIENTS ARE GATHERED INTO GROUPS OF 25-40 MEMBERS AND ONE LOAN IS EXTENDED BY THE LENDER TO THE GROUP. THE GROUP MEMBERS THEN DIVIDE THIS LOAN AMOUNT AMONGST THEMSELVES. ALL MEMBERS OF THE GROUP JOINTLY AND SEVERALLY GUARANTEE THE TOTAL AMOUNT BORROWED BY THE GROUP FROM THE LENDER. THE GROUP MANAGES ITS OWN AFFAIRS, AND QUITE OFTEN ADD A MARGIN ONTO THE ULTIMATE LENDING RATE AND MOBILIZE SAVINGS.

STRENGTHS:

1). IT PROVIDES ECONOMIES OF SCALE.

2). VERY EFFECTIVE IN RURAL AREAS (HENCE THE NAME VILLAGE BANKING)

3). THE JOINT AND SEVERAL LIABILITY CONCEPT BASED ON LOCAL MARKET KNOWLEDGE HAS BEEN EFFECTIVE IN ENSURING GOOD CREDIT QUALITY.

WEAKNESSES:

1). GENERALLY CAN ONLY PROVIDE ONE STANDARDIZED LOAN PRODUCT TO MEMBERS OF THE VILLAGE BANK.

2). THE VARIATION BETWEEN LOAN SIZES FOR INDIVIDUALS WITHIN THE VILLAGE BANK ARE LIMITED.

3). VERY RIGID OPERATING PROCEDURES.

4). GENERALLY A FAIRLY SMALL CAP ON THE MAXIMUM AMOUNT THAT CAN BE BORROWED.

5). CAN BE DIFFICULT TO FORM.

TYPICAL METHODOLOGIES:

SOLIDARITY GROUP LENDING:

CLIENTS ARE FORMED INTO GROUPS OF 5-10 INDIVIDUALS WHO SELF-SELECT THEMSELVES. THE LENDER EXTENDS A LOAN TO THE GROUP, AND EACH GROUP MEMBER JOINTLY AND SEVERALLY GUARANTEES THE LOAN REPAYMENTS OF THE OTHER MEMBERS. NO MEMBER RECEIVES A FOLLOW-ON LOAN UNTIL THE GROUP HAS ENTIRELY REPAID THE EXISTING LOAN. THERE IS A LIMITED AMOUNT OF SELF-MANAGEMENT BY THE GROUP

STRENGTHS:

1). CAN PROVIDE LARGER LOANS THAN THE VILLAGE BANKING MODEL CAN SUPPLY.

2). CONTINUES TO APPLY THE IDEA OF SOCIAL COLLATERAL.

3). STILL DELIVERS ECONOMIES OF SCALE.

4). SOLIDARITY GROUPS ARE EASIER TO FORM THAN ARE VILLAGE BANKS.

5). EFFECTIVE IN URBAN AREAS.

6). ALLOWS THE EXTENSION OF LARGER LOANS AND A WIDER RANGE OF LOAN AMOUNTS THAN THE VILLAGE BANK MODEL.

WEAKNESSES:

1). GROUP MEMBERS HAVE A GREATER EXPOSURE IF ONE BORROWER DEFAULTS. THIS CAUSES DISSENSION IN THE GROUP WHEN ONE MEMBER STARTS HAVING DIFFICULTY REPAYING.

2). SOME LIMITATIONS ON THE LOAN PRODUCTS OFFERED, BOTH IN TERMS OF THE LOAN AMOUNT AND THE TERMS OF REPAYMENT.

3). CAN CREATE SYSTEMIC RISK IF ALL GROUP MEMBERS WORK IN THE SAME SKILLS AND/OR GEOGRAPHIC ZONES.

4). SOMETIMES CLIENTS HAVE TROUBLE KEEPING A COHESIVE GROUP TOGETHER.

TYPICAL METHODOLOGIES:

INDIVIDUAL LOANS

LOANS ARE INDIVIDUALLY TAILORED TO THE NEEDS OF THE INDIVIDUAL BORROWERS OPERATING UNDER THE GENERAL PARAMETERS OF EACH LOAN PRODUCT.

STRENGTHS:

1). PROVIDES A LOAN PRODUCT BETTER SUITED TO THE CLIENT'S NEEDS.

2). PROVIDES FOR BETTER CREDIT ANALYSIS

3). PERMITS LARGER LOANS TO BE EXTENDED.

4). THIS IS MUCH PREFERRED BY THE CLIENTS.

WEAKNESSES:

1). CAN BE DIFFICULT TO ACHIEVE THE NECESSARY ECONOMIES OF SCALE.

2). REQUIRES EFFECTIVE CREDIT ANALYSIS, WHICH IS OFTEN BEYOND THE SKILLS OF THE LOAN OFFICERS.

3). REQUIRES AN EFFECTIVE MANAGEMENT INFORMATION SYSTEM (MIS).

4). REQUIRES A MORE SOPHISTICATED SET OF MANAGEMENT SKILLS.

5). IS MORE DIFFICULT TO ENFORCE REPAYMENT DUE TO THE LOSS OF THE SOCIAL COLLATERAL

6). NEEDS A MORE CREDITOR FRIENDLY LEGAL AND SOCIAL ENVIRONMENT THAN DO THE OTHER METHODOLOGIES.

THE MICROFINANCE PROVIDERS IN JORDAN:

THERE ARE A CONSIDERABLE NUMBER OF CREDIT SUPPLIERS IN JORDAN.

MFIS ASSOCIATED/AFFILIATED WITH AMIR	NO. OF CLIENTS *(Up to June 31, 2001)*
MICROFUND FOR WOMEN	5,691
JORDAN MICROCREDIT COMPANY	1,359
AL AHLI MICROFINANCING COMPANY	818
CHF/Jordan Access to Credit Program	5,114

PUBLIC SECTOR AND QUASI PUBLIC SECTOR	NO. OF CLIENTS *(Up to February 28, 2001)*
DEVELOPMENT AND EMPLOYMENT FUND	6,200
THE ORPHANS FUND	16,000
THE AGRICULTURAL CREDIT CORPORATION	47,800
THE NATIONAL AID FOUNDATION	4,667
THE GENERAL UNION OF VOLUNTARY SOCIETIES	1,177
ANRWA	261

THE DEMAND FOR MICROFINANCE IN JORDAN

THE ESTIMATED TOTAL NUMBER OF MICROBUSINESSES IN JORDAN IS ABOUT 217,000

THERE ARE TWO SECTORS:

THE INFORMAL SECTOR (63 % WOMEN)
THE FORMAL SECTOR (97% MEN)

THE NUMBER OF MICROBUSINESSES WHO ARE PREPARED TO BORROW WAS ESTIMATED AT ABOUT 154,000 IN LATE 2000.

THE NUMBER OF MICROBUSINESSES INTERESTED IN BORROWING IS PROJECTED TO GROW TO APPROXIMATELY 180,000-185,000 BY 2004.

OF THE BUSINESSES THAT OPERATE IN URBAN AND PERI-URBAN AREAS (TYPICAL TARGET MARKET OF AMIR PROGRAM PARTICIPANTS)

	OCCUPATION % OF TOTAL
RETAIL TRADE	**60%**
GENERAL SERVICES	**12%**
FOOD PROCESSING	**5%**
HAIR DRESSERS	**6%**
GARMENT MANUFACTURING	**5%**

THE DEMAND FOR MICROFINANCE IN JORDAN

THE MARKET SEGMENTATION BY LOAN SIZE

	% OF TOTAL
BETWEEN 200 JD-650 JD	**8%**
651 JD-1,000 JD	**12%**
1,001 JD- 2,000 JD	**20%**
2,001-3,000 JD	**15%**
3,001-4,500 JD	**7%**
4,501- 7,000 JD	**25%**
GREATER THAN 7,000 JD	**12%**

WHO ARE THE CLIENTS?

1). OPERATE IN URBAN OR PERI-URBAN AREAS.

2). EMPLOY LESS THAN 4 PEOPLE.

3). A LARGE PERCENTAGE OPERATE OUT OF THEIR HOMES.

4). FOR MANY THE ONLY RELATIONSHIP WITH A BANK IS VIA A SAVINGS ACCOUNT

5). A SIZEABLE PROPORTION ARE WOMEN.

6). A LARGE PROPORTION SELL ON CREDIT TO THEIR CLIENTS.

7). GENERALLY A LOW TECHNOLOGY OCCUPATION.

8). ONE FAMILY MEMBER HAS FULL TIME EMPLOYMENT

TYPICAL PRODUCTS PROVIDED TO CLIENTS

SHORT TERM WORKING CAPITAL LOANS

6-18 MONTH MATURITY
150 JD- 3,200 JD LOAN AMOUNT
FORTNIGHTLY/MONTHLY REPAYMENTS

SPECIAL EVENT LOANS

RAMADAN LOANS,
BACK TO SCHOOL LOANS
2 MONTHS MATURITY
250 JD LOAN AMOUNT
MONTHLY REPAYMENTS

LONG TERM LOANS

UP TO 36 MONTHS MATURITY
14,000 JD LOAN AMOUNT
MONTHLY REPAYMENTS

CRITICAL SUCCESS FACTORS FOR A MICROFINANCE INSTITUTION.

CLEAR STRATEGIC VISION.

INTIMATE KNOWLEDGE OF THE MARKET.

COMPREHENSIVE, CURRENT BUSINESS PLAN

EXPERIENCED, DYNAMIC MANAGEMENT WITH A BACKGROUND IN THE LENDING OPERATIONS OF BANKING; WHO CAN ACT PROACTIVELY, RATHER THAN REACTIVELY.

AN EFFECTIVE LOAN INITIATION AND APPROVAL SYSTEM

AN EFFECTIVE MIS SYSTEM.

A TIMELY, CONCISE REPORTING SYSTEM.

A NEAR 100% LOAN REPAYMENT RATE

A TREASURY MANAGEMENT/ CASH FLOW MANAGEMENT SYSTEM

A FAST ACTING, EFFICIENT LOAN RECOVERY SYSTEM FOR LOANS IN ARREARS

UNDERTAKE LOAN PORTFOLIO RISK MANAGEMENT.

ADEQUATE LIQUIDITY, INCLUDING A LIQUIDITY RESERVE POSITION.

WELL TRAINED CREDIT/FIELD OFFICERS WHO VIEW THE MFI AS A BUSINESS, NOT A CHARITY.

WELL DESIGNED, PROFITABLE PRODUCTS THAT ARE APPROPRIATE FOR THEIR MARKET PLACE.

ABILITY TO RETAIN GOOD CLIENTS THROUGH:

- **KNOWING WHO ARE THESE CLIENTS**
- **PROMPT LOAN DISBURSEMENTS**
- **PROGRESSIVELY LARGER LOANS- COULD MEAN PROVIDING TAILORED LOAN PRODUCTS**

THE MANAGEMENT TEAM OF AN MFI

REQUIRED SKILL BASE AND EXPERIENCE

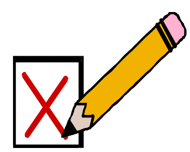
- **BANKING EXPERIENCE**
- **COMMITMENT TO THE VISION OF THE MFI**
- **LOCAL MARKET KNOWLEDGE**
- **EXPERIENCE IN CREDIT ANALYSIS AND LOAN RECOVERY**
- **FINANCIAL ANALYSIS AND INTERPRETATION**
- **TREASURY MANAGEMENT SKILLS**
- **ACCOUNTING SKILLS (KNOW THE DIFFERENCE BETWEEN CASH AND ACCRUAL ACCOUNTING)**

THE MANAGEMENT TEAM OF AN MFI

WHAT SENIOR MANAGEMENT SHOULD BE DOING .

- **MANAGING THE INSTITUTION**
- **PLANNING FUTURE DEVELOPMENTS RATHER THAN REACTING TO EVENTS**
- **KEEPING ON TOP OF THEIR MARKETPLACE**
- **STAYING CLOSE TO AND LISTENING TO THE CLIENTS.**
- **FUND RAISING**
- **MANAGING DONORS**

WHAT SENIOR MANAGEMENT SHOULD NOT BE DOING



- **HANDLING DAILY PROCEDURAL ISSUES**
- **ATTENDING ENDLESS MICROFINANCE CONFERENCES**
- **MAKING UNREALISTIC ASSUMPTIONS ABOUT GROWTH**
- **MAKING UNREALISTIC ASSUMPTIONS ABOUT THE LOAN DROP-OUT RATE.**

THE LEGAL STATUS OF MFIS

THE FOUR MFIs ASSOCIATED WITH THE AMIR PROGRAM ARE REGISTERED EITHER AS:

- **NOT FOR PROFIT LIMITED LIABILITY COMPANIES**
- **FOR PROFIT LIMITED LIABILITY COMPANIES**

STATUTORY REQUIREMENTS REGARDING SAVINGS:

- **ARTICLE 4 (B) OF THE BANKING LAW OF 1999 FORBIDS ANY NON-BANK FINANCIAL INSTITUTION OR FIRM TO MOBILIZE SAVINGS.**
- **IF THE MFIS WISH TO MOBILIZE SAVINGS THEY WILL HAVE TO REGISTER AS A BANK AND RAISE 20,000,000 JD IN CAPITAL.**

DANGER SIGNS FOR AN MFI

DETERIORATING PORTFOLIO AT RISK RATIO.

AN INCREASE IN THE AMOUNT OF LOANS BEING RESCHEDULED.

HIGH CLIENT DROP-OUT RATE.

MANAGEMENT ATTEMPTING TO CONTINUALLY GROW THE PORTFOLIO BY MORE THAN 50% A YEAR.

REPORTS THAT ARE INCOMPLETE, LATE, OR NON-EXISTENT

A NARROWING SPREAD BETWEEN THE EFFECTIVE ANNUAL INTEREST RATE AND THE WEIGHTED AVERAGE COST OF FUNDS.

CONSISTENTLY MISSING FORECAST/BUDGETED PROJECTIONS OF PORTFOLIO, INCOME AND/OR EXPENSES.

LOAN BRACKET CREEP. PROGRESSIVELY LARGER LOANS AND/ OR LONGER MATURITIES

CREDIT QUALITY CREEP. MAKING LOANS TO INCREASINGLY MARGINAL CLIENTS.

HIGH STAFF TURNOVER-PARTICULARLY AT THE FIELD/CREDIT OFFICER LEVEL

A SHARP INCREASE IN THE JD AMOUNT OF THE INITIAL LOAN AMOUNT OFFERED TO NEW CLIENTS.

CONCENTRATION OF RISK IN THE LOAN PORTFOLIO. LOANS BY LOCATION, OR BY THE TYPE OF BUSINESS BEING FUNDED.

INABILITY TO PROMPTLY EXTEND REPEAT LOANS TO EXISTING CUSTOMERS.

ONGOING LIQUIDITY CRISES.

OVER-RELIANCE ON CONSULTANTS FOR TECHNICAL ASSISTANCE AFTER THE START-UP PHASE.

THE INFORMATION THAT THE BOARD OF DIRECTORS SHOULD REQUIRE OF MANAGEMENT.

- **FULL DETAILS OF THE LOAN PORTFOLIO**

- **ABILITY TO SEGMENT THE LOAN PORTFOLIO**

- **ABILITY TO PRODUCE COMPREHENSIVE FINANCIAL REPORTS AT LEAST MONTHLY AND TO ANALYSE THE RESULTS.**

- **DAILY DETAILS OF LOAN REPAYMENTS DUE AND NOT RECEIVED**

- **DETAILS OF THE PROFITABILITY OF THE INDIVIDUAL LOAN PRODUCTS**

- **CASELOADS OF THE FIELD/CREDIT AGENTS.**

- **WHAT IS THE BREAK-EVEN CASELOAD/PORTFOLIO FOR A LOAN OFFICER.**

- **PROVIDE REASONS FOR ANY VARIANCES BETWEEN THE BUDGET/ FORECAST LOAN PORTFOLIO, LIQUIDITY, INCOME AND EXPENSES AND THE ACTUAL RESULTS.**

GENERAL CATEGORIES OF RISKS FACED BY MFIs:

CREDIT RISK

THE RISK THAT THE BORROWER WILL NOT REPAY

LIQUIDITY RISK

THE RISK THAT THE MFI LACKS AVAILABLE CASH TO MEET ITS OBLIGATIONS

MATURITY MISMATCH RISK

THAT LIABILITIES COMING DUE CANNOT BE REPAID DUE TO LIQUIDITY BEING TIED UP ON ASSETS WITH A DIFFERENT MATURITY CYCLE.

OPERATIONAL RISK

THE RISK THAT POOR MANAGEMENT AND OPERATIONAL DECISIONS WILL LEAD TO LOSSES

MARKETING RISK

THE RISK THAT MANAGEMENT WILL PROVIDE THE WRONG LOAN PRODUCT TO THE MARKET.

REPUTATION RISK

THE RISK THAT THE MFI WILL LOSE ITS REPUTATION AS A RELIABLE INSTITUTION DUE TO SOME ACTION THAT IMPACTS ITS MARKET PLACE.

MORAL HAZARD

THE PASSIVE ASSUMPTION THAT THE INSTITUTION (OR CLIENT) WILL BE RESCUED FROM THE CONSEQUENCES OF A POOR BUSINESS OR FINANCIAL DECISION.

KEY INDICATORS WITH WHICH THE BOARD SHOULD BE FAMILIAR:

LOAN PORTFOLIO:

PORTFOLIO AT RISK:

BALANCE OF LOANS OUTSTANDING THAT HAVE PAYMENTS IN ARREARS*
LOAN PORTFOLIO OUTSTANDING

THIS MEASURES THE POTENTIAL AMOUNT OF DEFAULT RISK IN THE PORTFOLIO

LOAN LOSS PROVISION RATIO:

LOAN LOSS PROVISION
LOAN PORTFOLIO OUTSTANDING

INDICATES THE PROVISIONING REQUIREMENTS ON THE LOAN PORTFOLIO FOR THE CURRENT PERIOD.

PORTFOLIO IN ARREARS:

PAYMENTS IN ARREARS*
LOAN PORTFOLIO OUTSTANDING

INDICATES THE RATIO OF THE AMOUNT OF LOAN REPAYMENTS DUE AND NOT RECEIVED

LOAN RESCHEDULING RATIO:

LOANS RESCHEDULED OUTSTANDING
LOAN PORTFOLIO OUTSTANDING

HIGHLIGHTS THE PROPORTION OF LOANS THAT HAVE BEEN RESCHEDULED TO KEEP THEM CURRENT.

KEY INDICATORS WITH WHICH THE BOARD SHOULD BE FAMILIAR:

PROFITABILITY

OPERATING SELF SUFFICIENCY RATIO:

FINANCIAL INCOME
FINANCIAL, OPERATIONAL &
LOAN LOSS PROVISION EXPENSES

SHOWS THE ABILITY TO COVER THE COSTS OF OPERATIONS FROM INTERNALLY GENERATED INCOME

FINANCIAL SELF SUFFICIENCY RATIO:

FINANCIAL INCOME
FINANCIAL, OPERATIONAL & LOAN LOSS
PROVISION EXPENSES PLUS IMPUTED
COST OF CAPITAL

SHOWS THE ABILITY TO BE FULLY SUSTAINABLE FOR THE LONG TERM BY COVERING ALL OPERATING COSTS AND MAINTAINING THE VALUE OF THE CAPITAL

NET INTEREST MARGIN:

INTEREST REVENUE-INTEREST EXPENSE
AVERAGE LOAN PORTFOLIO OUTSTANDING

TRACKS THE AMOUNT OF INCOME AVAILABLE FOR OPERATIONAL EXPENSES AND PROFIT.

OPERATING COST RATIO:

OPERATING EXPENSES
LOAN PORTFOLIO OUTSTANDING

INDICATOR OF THE EFFICIENCY OF LENDING OPERATIONS

KEY INDICATORS WITH WHICH THE BOARD SHOULD BE FAMILIAR:

CAPITALIZATION:

EQUITY MULTIPLIER:

$$\frac{\textbf{TOTAL ASSETS}}{\textbf{TOTAL EQUITY}}$$

A MICROFINANCE VERSION OF DEBT TO TOTAL ASSETS RATIO

<u>KEY INDICATORS WITH WHICH THE BOARD SHOULD BE FAMILIAR:</u>

<u>EFFICIENCY:</u>

COST PER UNIT OF MONEY LENT:

<u>OPERATING COSTS</u>
TOTAL LOANS DISBURSED

INDICATES THE EFFICIENCY OF DISBURSED LOANS IN JD TERMS

COST PER LOAN MADE:

<u>OPERATING COSTS</u>
NUMBER OF LOANS EXTENDED

INDICATES EFFICIENCY OF LOANS MADE IN TERMS OF THE NUMBER OF LOANS DISBURSED.

NUMBER OF ACTIVE BORROWERS PER LOAN OFFICER:

<u>NUMBER OF ACTIVE BORROWERS</u>
NUMBER OF LOAN OFFICERS

INDICATES PERFORMANCE OF THE LOAN OFFICER AND EFFICIENCY OF THE METHODOLOGY

PORTFOLIO PER CREDIT OFFICER:

<u>LOAN PORTFOLIO OUTSTANDING</u>
NUMBER OF LOAN OFFICERS

INDICATES FINANCIAL PRODUCTIVITY OF LOAN OFFICERS

KEY INDICATORS WITH WHICH THE BOARD SHOULD BE FAMILIAR:

GENERAL:

LOAN DROPOUT RATE:

$$\frac{\text{NUMBER OF EXISTING BORROWERS NOT REQUESTING NEW LOANS}}{\text{NUMBER OF EXISTING BORROWERS ELIGIBLE FOR NEW LOANS}}$$

INDICATES THE RETENTION RATE OF THOSE WHO SHOULD BE YOUR BEST CLIENTS (A CLIENT SATISFACTION MEASUREMENT).

YIELD ON PORTFOLIO:

$$\frac{\text{INCOME FROM THE LOAN PORTFOLIO}}{\text{AVERAGE LOAN PORTFOLIO OUTSTANDING}}$$

THIS SHOULD APPROXIMATE THE EFFECTIVE ANNUAL INTEREST RATE CHARGED BY THE MFI.

ANNUAL GROWTH IN THE LOAN PORTFOLIO:

THE GROWTH ON THE LOAN PORTFOLIO IN JD

ANNUAL GROWTH IN THE NUMBER OF BORROWERS:

THE GROWTH OF THE PORTFOLIO IN TERMS OF NUMBERS OF BORROWERS

AVERAGE LOAN AMOUNT OUTSTANDING:

$$\frac{\text{TOTAL LOAN PORTFOLIO OUTSTANDING}}{\text{NUMBER OF LOANS OUTSTANDING}}$$

MEASURES THE AVERAGE LOAN AMOUNT PER CLIENT. USEFUL FOR MEASURING THE PROFITABILITY PER CLIENT.

INITIAL LOAN SIZE

USEFUL FOR VERIFYING WHO ARE THE REAL TARGET MARKET FOR THE MFI AND THE PROFITABILITY OF EACH LOAN EXTENDED.

SPECIAL MICROFINANCE TERMS:

TARGETING: A PHRASE OFTEN USED BY DONORS WHO WANT THE MFI TO LEND TO A SPECIFIC GROUP OF BORROWERS.

OUTREACH: WHAT SEGMENTS OR PROPORTION OF THE POTENTIAL POPULATION DOES THE MFI SERVE? OUTREACH CAN CATEGORIZE THE POPULATION SERVED BY:

- **THE GROSS NUMBER OF CLIENTS.**
- **THE INCOME LEVEL OF THE CLIENTS**
- **GENDER**
- **PURPOSE OF THE LOAN**
- **GEOGRAPHIC REGION OR ZONE**
- **LOAN SIZE.**
- **FAMILY SIZE**

OUTREACH OFTEN IS LINKED WITH TARGETING

BEST PRACTICES:

THESE ARE POLICIES, PROCEDURES AND PRACTICES THAT HAVE BEEN IDENTIFIED AS BEING ESPECIALLY APPROPRIATE TO THE RUNNING OF MICROFINANCE INSTITUTIONS. THE PHRASE ORIGINATED WITH USAID BUT IS RAPIDLY BEING TAKEN OVER BY CGAP. THESE POLICIES, PROCEDURES AND PRACTICES CAN BE EXTREMELY GENERAL AND INCLUDE:

ORGANIZATIONAL ARCHITECTURES
MIS SYSTEMS
MARKETING
RISK MANAGEMENT
REGULATIONS AND SUPERVISION
RURAL FINANCE
CREDIT METHODOLOGIES
ALTERNATIVE FUND MECHANISMS

SPECIAL MICROFINANCE TERMS:

CGAP:

THE CONSULTATIVE GROUP TO ASSIST THE POOREST

THE ORGANIZATION, WHICH IS HOUSED WITHIN THE WORLD BANK, HAS BEEN ESTABLISHED BY MAJOR MULTILATERAL DONORS TO SUPPORT MICROFINANCE. ITS MISSION IS TO SUPPORT MFI PROVIDE HIGH QUALITY FINANCIAL SERVICES TO THE VERY POOR ON A SUSTAINABLE BASIS.

THE GENDER ISSUE:

THIS PHRASE RELATES TO THE IDEA OF MAKING MICROFINANCE AVAILABLE TO WOMEN ON THE BASIS THAT THEY ARE SEGREGATED AGAINST BY THE FORMAL FINANCIAL SECTOR; AND THAT QUITE OFTEN THEY ARE BETTER CREDIT RISKS THAN MEN.

SOCIAL GOALS:

THESE ARE TERMS INCLUDED IN THE STRATEGIC VISION OF MFIS THAT DO NOT RELATE TO FINANCIAL TARGETS, RATHER THEY REFER TO THE IMPACT THE MFI CAN HAVE ON THE COMMUNITY IT SERVES. THESE SOCIAL GOALS CAN RELATE TO EDUCATION, HEALTH, LITERACY, AND FOOD SECURITY.

COPING STRATEGIES FOR MFIs FACED WITH A DISASTER:

THE PRIMARY GOAL IS TO PRESERVE THE QUALITY OF YOUR LOAN PORTFOLIO AND THE ABILITY OF YOUR BEST CLIENTS TO CONTINUE OPERATING UNTIL THERE IS A GENERAL RECOVERY.

THESE STRATEGIES INCLUDE:

- **UNDERTAKE A RAPID PORTFOLIO REVIEW**
- **HAVING A DISASTER RESERVE CREATED IN ADVANCE.**
- **DO NOT EXTEND LOANS TO NEW CLIENTS**
- **NO STEP INCREASES IN LOANS**
- **PREPARE A STRATEGY/ BUSINESS PLAN BEFORE APPROACHING FUNDERS/DONORS FOR ASSISTANCE.**

SUMMARY AND CONCLUSION:

- **THE MFI MUST BE RUN AS A BUSINESS**

- **THE NEED FOR ECONOMIES OF SCALE**

- **MARKET CONDITIONS DICTATE THE NEED FOR A FOCUSED TARGET MARKET AND BUSINESS PLAN**

- **LOAN PORTFOLIO QUALITY IS KEY**

- **A GOOD MIS SYSTEM IS CRITICAL**